



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	01/19/05	Bill No:	AB 168
Tax:	Sales and Use	Author:	Ridley-Thomas
Related Bills:			

BILL SUMMARY

This bill would require the Department of Finance (DOF) to submit to the Legislature a report of tax expenditures currently in effect. The bill would specify that, among other things, based on information provided by the Board to the extent feasible, the report include the number of tax returns or taxpayers affected by any sales or use tax expenditure, the distribution of that expenditure, and the size and type of business or industry to which that expenditure is made available.

ANALYSIS

Current Law

Since 1971, pursuant to Section 13305 of the Government Code, the Department of Finance has been required to provide a tax expenditure report to the Legislature. Chapter 1762, Statutes of 1971, required that the report be submitted to the Legislature once every two years. Chapter 268, Statutes of 1984, increased the reporting frequency to once a year. The required report includes each of the following:

- A comprehensive list of tax expenditures.
- Additional detail on individual categories of tax expenditures.
- Historical information on the enactment and repeal of tax expenditures.

Proposed Law

This bill would add Article 7.5 (commencing with Section 9147.1) to Chapter 1.5 of Part 1 of Division 2 of Title 2 of, and to repeal Section 13305 of, the Government Code to do, among other things, the following:

- 1) Define "tax expenditure" as a "credit, deduction, exclusion, exemption, or any other tax benefit as may be provided for by state law."
- 2) Require the DOF to submit a tax expenditure report by September 15 each even-numbered year starting in 2006, that would contain the following:
 - a) A description of each expenditure, its statutory, constitutional, or legal authority, its original intent, and the estimated revenue loss under the Sales and Use Tax Law, the Personal Income Tax Law, and the Corporation Tax Law.
 - b) With respect to the sales and use tax expenditures that are separately identified on returns or claims, information on the number of returns or taxpayers affected, and the distribution of each tax expenditure. For business tax expenditures, information on the size, total receipts, and type of business, as provided by the Board to the extent feasible.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position

- 3) Require the DOF to submit the same report in odd-numbered years, but may be limited to new or revised tax expenditures and to significant updates, revisions, or corrections of information in the prior year's report.

Background

This bill is identical to Assembly Bill 2106 (Ridley-Thomas) of the 2004 session. AB 2106 was developed as a result of Assembly Budget Committee Oversight hearings at which was discussed the usefulness of regular ongoing review and evaluation of tax expenditures as a means to eliminate wasteful or ineffective programs. Board staff participated in the oversight hearings and had no concerns in complying with the provisions of the bill.

AB 2106 was vetoed by Governor Schwarzenegger. The Governor's veto message states:

"Under existing law, the Department of Finance already is required to provide an annual tax expenditure report to the Legislature containing specific information. This bill changes the type of information that is provided in the annual report. However, some of the information that Department of Finance would be required to report is not available. For example, the original intent of a given tax expenditure is often not clearly defined in the enabling statute. In addition, the number and income distribution of taxpayers benefiting from sales tax exemptions would not be known because this information is not required to be reported by retailers when filing their tax returns. Furthermore, some of the information might not be available for reporting to the Legislature because of existing confidentiality requirements."

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author to provide for a systematic review of tax expenditures in order to determine their effectiveness.
2. **The Board does not have specific data on tax expenditures.** In general, revenue estimates and expenditure data for the Personal Income Tax and Corporation Tax Laws are easier to quantify than they are for the Sales and Use Tax Law. Personal income and corporation tax returns contain significant detail regarding different sources of income and types of exemptions, exclusions, deductions, and credits claimed. Thus, tax return data are often available when estimating the fiscal impact of various income and corporate tax expenditure programs. In contrast, returns filed by taxpayers under the Sales and Use Tax Law (a copy of which is attached) contain little specific information regarding tax expenditures.

As shown on the attached sales and use tax return, some of the more common tax expenditures allowed under the Sales and Use Tax Law are separately identified on the return itself for purposes of allowing taxpayers to claim the deduction. These include deductions for, among others, sales of food products, sales to the U.S. Government, sales in interstate or foreign commerce, and nontaxable labor (note, the law contains numerous other tax exemptions and exclusions not separately identified on the return). However, instead of actually itemizing these deductions, many taxpayers simply report their taxable sales, netting out any exempt sales. Consequently, return information does not capture specific data on the myriad of tax

exemptions and exclusions provided under the law, and is not a reliable source to use in making estimates of revenue losses attributable to those exemptions and exclusions. Consequently, the Board generally relies on independent data sources when estimating the revenue impacts of various sales tax expenditure programs.

The exception to this is for partial exemptions. The Board currently requires the taxpayer to specify the amount of those exemptions that apply to only a portion of the combined state and local sales and use tax. There are currently five such exemptions in effect:

Teleproduction Equipment

Farm Equipment

Diesel Fuel Used in Farming and Food Processing

Timber Harvesting Equipment and Machinery

Racehorse Breeding Stock

Sales of these commodities are exempt from the *state* sales and use tax. Local and special district sales and use taxes continue to apply. In order for a taxpayer to claim these exemptions, they must report the amount of the transactions that are subject to the partial exemption.

Consequently, since the bill specifies that the Board would provide the information to the extent feasible, it is assumed that the Board would provide the DOF with the information we are currently capturing.

3. **The Board's Publication 61, *Sales and Use Taxes: Exemptions and Exclusions*, provides a detailed listing of various exemptions and exclusions from the sales and use tax.** Publication 61 summarizes the various sales and use tax exemptions and exclusions. The publication has two sections: first by category and second by alphabetical reference. The listings provide a brief general description of the exemption or exclusion, including the statutory authority. The listing by category also provides an estimate of the revenue loss of the exemption or exclusion, if available. As previously stated (see Comment 2), a revenue loss of a particular tax expenditure is not always possible to quantify.

COST ESTIMATE

As explained previously, the Board does not capture reliable data on tax expenditures from tax returns or from taxpayers, other than that obtained on the five partial tax exemptions. The bill states that the DOF would prepare the report with information from the Board to the extent feasible. It is assumed that the Board would provide the DOF information that we currently obtain from returns. Based on that assumption, any costs associated with this bill would be insignificant.

REVENUE ESTIMATE

To the extent that future reviews and evaluations result in the identification and termination of ineffective or inappropriate tax expenditures, enactment of this measure could result in unknown additional revenues.

ATTACHMENT

<http://www.boe.ca.gov/pdf/boe401a2.pdf>



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